LPL Financial

LPL Financial
Q4 2023 Earnings
Prepared Remarks

Notice to Investors: Safe Harbor Statement

Statements in this presentation regarding LPL Financial Holdings Inc.'s (together with its subsidiaries, the "Company") future financial and operating results, growth, priorities, business strategies, capabilities, and outlook, including forecasts and statements relating to the Company's future advisory and brokerage asset levels and mix, organic asset growth, market share, deposit betas, core G&A* expenses (including outlook for 2024) and expenses associated with the Company's strategic relationship with Prudential Financial, Inc. ("Prudential"), service offerings, operating margin, Gross Profit* benefits, EBITDA* benefits, target leverage ratio, client cash balances and yields, service and fee revenue, investments, acquisitions (including Liquidity & Succession transactions), capital returns, planned share repurchases, if any, the anticipated closing of pending transactions, and the amount and timing of the onboarding of acquired, recruited or transitioned brokerage and advisory assets, as well as any other statements that are not related to present facts or current conditions or that are not purely historical, constitute forward-looking statements. They reflect the Company's expectations and objectives as of February 1, 2024 and are not guarantees that the expectations or objectives expressed or implied will be achieved. The achievement of such expectations and objectives involves risks and uncertainties that may cause actual results, levels of activity or the timing of events to differ materially from those expressed or implied by forward-looking statements. Important factors that could cause or contribute to such differences include: difficulties and delays in onboarding the assets of acquired or recruited advisors, including the receipt and timing of regulatory approvals that may be required; disruptions in the businesses of the Company that could make it more difficult to maintain relationships with advisors and their clients; the choice by clients of acquired or recruited advisors not to open brokerage and/or advisory accounts at the Company; changes in general economic and financial market conditions, including retail investor sentiment; changes in interest rates and fees payable by banks participating in the Company's client cash programs, including the Company's success in negotiating agreements with current or additional counterparties; the Company's strategy and success in managing client cash program fees; changes in the growth and profitability of the Company's fee-based offerings; fluctuations in the levels of advisory and brokerage assets, including net new assets, and the related impact on revenue; effects of competition in the financial services industry and the success of the Company in attracting and retaining financial advisors and enterprises, and their ability to market financial products and services effectively; whether the retail investors served by newly-recruited advisors choose to move their respective assets to new accounts at the Company; the effect of current, pending and future legislation, regulation and regulatory actions, including disciplinary actions imposed by federal and state regulators and self-regulatory organizations; the cost of settling and remediating issues related to regulatory matters or legal proceedings, including actual costs of reimbursing customers for losses in excess of our reserves; changes made to the Company's services and pricing, including in response to competitive developments and current, pending and future legislation, regulation and regulatory actions, and the effect that such changes may have on the Company's Gross Profit* streams and costs; execution of the Company's capital management plans, including its compliance with the terms of the Company's amended and restated credit agreement, the committed revolving credit facility and LPL Financial's committed revolving credit facility, and the indentures governing the Company's senior unsecured notes; the price, availability and trading volumes of shares of the Company's common stock, which will affect the timing and size of future share repurchases by the Company, if any; whether advisors affiliated with Prudential will transition registration to the Company and whether assets reported as serviced by such financial advisors will translate into assets of the Company; the failure to satisfy the closing conditions applicable to the strategic relationship agreement between the Company and Prudential, including regulatory approval; the negotiation of the civil monetary penalty and definitive documentation in connection with the settlement of the industry-wide civil investigation into compliance with records preservation requirements for business-related electronic communications stored on personal devices applicable to broker-dealer firms and investment advisors; the execution of the Company's plans and its success in realizing the synergies, expense savings, service improvements or efficiencies expected to result from its investments, initiatives, and acquisitions, expense plans and technology initiatives; the performance of third-party service providers to which business processes have been transitioned; the Company's ability to control operating risks, information technology systems risks, cybersecurity risks and sourcing risks; and the other factors set forth in the Company's most recent Annual Report on Form 10-K, as may be amended or updated in the Company's Quarterly Reports on Form 10-Q or other filings with the Securities and Exchange Commission. Except as required by law, the Company specifically disclaims any obligation to update any forward-looking statements as a result of developments occurring after February 1, 2024 and you should not rely on statements contained herein as representing the Company's view as of any date subsequent to February 1, 2024.

Actual remarks made on the Company's earnings conference call could vary from the prepared remarks presented here. A webcast replay of the Company's earnings conference call will be available on the Investor Relations section of the Company's website, investor.lpl.com/events. Please refer to the Company's earnings release for additional information.

*Notice to Investors: Non-GAAP Financial Measures

The prepared remarks set forth herein include discussion of certain non-GAAP financial measures. At the time these remarks were made, listeners were referred to the Company's earnings release, which had been previously published on the Company's website at investor.lpl.com, and which contained reconciliations of such non-GAAP financial measures to comparable GAAP figures. Management believes that presenting certain non-GAAP financial measures by excluding or including certain items can be helpful to investors and analysts who may wish to use this information to analyze the Company's current performance, prospects and valuation. Management uses this non-GAAP information internally to evaluate operating performance and in formulating the budget for future periods. Management believes that the non-GAAP financial measures and metrics discussed herein are appropriate for evaluating the performance of the Company. These non-GAAP financial measures include but are not limited to adjusted EPS, gross profit, core G&A, EBITDA and Credit Agreement EBITDA.

Dan Arnold, President and CEO

Thank you, Operator, and thanks to everyone for joining our call today.

Over the past quarter and throughout 2023, our advisors continued to provide their clients with personalized financial guidance on the journey to help them achieve their life goals and dreams. As we enter the new year, we thank our advisors for their continued commitment and dedication, while we remain focused on our mission of taking care of them, so they can take care of their clients.

During the fourth quarter, we continued to see the appeal of our model grow due to the combination of our robust and feature-rich platform, the stability and scale of our industry-leading model, and our capacity and commitment to invest back into the platform. As a result, we continue to make solid progress in helping advisors and enterprises solve challenges, and capitalize on opportunities better than anyone else, and thereby serve as the most appealing player in the industry.

With respect to our performance, we delivered another quarter of solid results while also continuing to make progress on the execution of our strategic plan. I'll review both of these areas starting with our fourth quarter business results.

In the quarter, total assets increased to $1.4 trillion, as continued solid organic growth was complemented by higher equity markets. Regarding organic growth, fourth quarter organic net new assets were $25 billion, representing 8 percent annualized growth. This contributed to organic net new assets for the year of $100 billion, representing approximately a 9 percent growth rate.

In the fourth quarter, recruited assets were $17 billion, bringing our total for the full year to $80 billion. Prior to large enterprises, recruited assets for the full year were $67 billion, an increase of nearly 50% year-over-year, and a new annual record. This outcome was driven by the ongoing enhancements to our model, as well as our expanded addressable markets.

Looking at same store sales, our advisors remain focused on taking care of their clients and delivering a differentiated experience. As a result, our advisors are both winning new clients, and expanding wallet share with existing clients, a combination that drove solid same store sales in Q4.

At the same time, we continue to enhance the advisor experience through the delivery of new capabilities and technology, and the evolution of our service and operations functions. As a result, asset retention for the full year was approximately 99 percent.

Our fourth quarter business results led to solid financial outcomes with adjusted EPS of $3.51, which brought our full-year total to $15.72, an increase of 36 percent year-over-year.

Let’s now turn to the progress we made on our strategic plan.

As a reminder, our long-term vision is to become the leader across the advisor-centered marketplace. To do that, our strategy is to invest back into the platform to provide unprecedented flexibility in how advisors can affiliate with us, and to deliver capabilities and services to help maximize advisors’ success throughout the lifecycle of their businesses.

Doing this well gives us a sustainable path to industry leadership across the advisor experience, organic growth, and market share.

Now, to execute on our strategy, we organize our work into two strategic categories. Horizontal expansion, where we look to expand the ways that advisors and enterprises can affiliate with us, such that we compete for all 300,000 advisors in the marketplace. And vertical integration, where we focus on delivering capabilities, technology, and services that help our advisors differentiate and win in the marketplace and be great operators of their businesses.

With that as context, let's start with our efforts around horizontal expansion.

Over the fourth quarter, we saw strong recruiting in our traditional independent market, adding approximately $14 billion in assets. As a result of the ongoing appeal of our model and the evolution of our go-to-market approach, we maintained our industry-leading win rates while also expanding the breadth and depth of our pipeline.

With respect to our new affiliation models, Strategic Wealth, Employee, and our enhanced RIA offering, we delivered our strongest year to date, recruiting roughly $15 billion in assets, nearly double the total of the prior year. As we look ahead, we expect that the increasing awareness of these models in the marketplace and our ongoing enhancements to their capabilities will help drive a sustained increase in their growth.

Next, the traditional bank and credit union space continues to be a consistent contributor to organic growth, as we added approximately $1 billion of recruited assets in Q4.

In addition, large enterprises remained a meaningful source of recruiting in 2023, with the addition of Bank of the West and Commerce Bank. For 2024, we continue to prepare to onboard the retail wealth management business of Prudential Financial. As part of that process, our team has been on the road meeting with Prudential advisors, to provide them a preliminary orientation to our platform and the early feedback has been positive.

Looking ahead, we are confident that the appeal of our value proposition for enterprises, matched with our track record of successful execution, positions us well to help solve for the needs of a broad spectrum of institutions.

Now within our vertical integration efforts, we are focused on investing back into the model in order to deliver a comprehensive platform of capabilities, services, and technology that help our advisors differentiate and win in the marketplace and run thriving businesses.

As part of this effort, over the past quarter we continued to make progress on our aspiration of delivering an industry-leading service experience. This work includes continuing to make our service model more flexible and efficient through a multi-channel approach. The purpose of which is to offer a broad spectrum of service options, including human-centric support, digital capabilities, and artificial intelligence, such that we can provide advisors the information they need in the channel that works best for them.

In that spirit, over the last year we have continued to expand our digital capabilities including our digital hubs, which provide advisors “always-on” support in a centralized and intuitive format. Our investments in this area enabled us to expand from 2 digital hubs to 11 over the last year, with the newest being our Tax Hub, which helps advisors process tax business in a streamlined, highly-efficient way.

While we are still in the early innings of the adoption of this capability set, the percentage of advisor interactions that go through digital channels has roughly doubled over the last year, from 10% to 20%. And, as we continue to refine these capabilities, we believe digital solutions can ultimately serve as much as 50% of our service interactions.

Now, as an additional part of our vertical integration strategy, we continue to expand and enhance our services portfolio and are encouraged by the evolving appeal of our value proposition and the seasoning of our capabilities. As a result of solid demand, the number of advisors utilizing our portfolio of 14 available services continues to increase and we ended the year with nearly 3,900 active users, up 27 percent from a year ago.

Looking ahead, we remain focused on addressing the needs of a broader set of advisors, and are innovating on new services that will directionally double the size of our services portfolio over the next two years.

Now, one of the latest innovations in our services portfolio was inspired by our broader efforts to tackle the advisor transition process, which has historically been an industry-wide pain point given the friction and complexity of changing firms. That said, rather than seeing the transition process as a headwind, we view it as an important strategic opportunity, as the easier we can make it for advisors to change firms, the more it will drive up advisor movement in the industry, where we are well positioned to benefit as the market-leader in recruiting. And to help solve for that opportunity, we have developed several new transition-capabilities and solutions including: a live testing environment for advisors to familiarize themselves with our platform before transitioning over, fully-automated stages of the onboarding process, and a suite of transition services that includes Short-Term Admin, Branding, and Bookkeeping Support which help simplify the transition and onboarding journey and ultimately accelerate advisors' readiness and growth.

The early feedback on these transition services has been positive, and they are proving to be a catalyst for additional subscriptions, as 40% of advisors who use these solutions end up subscribing to one or more of our other ongoing services.

As we move forward, we will continue to challenge ourselves to solve for advisors' needs at every stage of their practice in order to help them build the perfect business for themselves, and ultimately maximize their success.

In summary, in the fourth quarter and throughout the year, we continued to invest in the value proposition for advisors and their clients, while driving growth and increasing our market leadership. As we look ahead, we remain focused on executing our strategy to help our advisors further differentiate and win in the marketplace and as a result, drive long-term shareholder value.

With that, I'll turn the call over to Matt.

Matt Audette, CFO and Head of Business Operations

Thank you, Dan, and I'm glad to speak with everyone on today's call.

Before I review our fourth quarter results, I would like to highlight our progress during 2023. Against an evolving market backdrop, we maintained our focus on supporting our advisors and their clients while executing on our strategic priorities. We continued to grow assets organically in both our traditional and new markets, successfully onboarded new enterprise clients and continued to make progress with our Liquidity & Succession solution. So as we enter 2024, we remain excited by the opportunities we have to serve and support our more than 22,000 advisors, while continuing to invest in our industry leading value proposition and drive organic growth.

Now let's turn to our fourth quarter business results. Total advisory and brokerage assets were $1.4 trillion, up 9% from Q3, as continued organic growth was complemented by higher equity markets. Total organic net new assets were $25 billion or approximately an 8% annualized growth rate.

Our Q4 recruited assets were $17 billion, which brought our total for the year to $80 billion. Looking ahead to Q1, our momentum continues, and we are on pace to deliver another strong quarter of recruiting.

As for our Q4 financial results… the combination of organic growth and expense discipline, led to adjusted EPS of $3.51.

Gross Profit was $1 billion 7 million, down $3 million sequentially.

Our payout rate was 87.6%, up 30 basis points from Q3 due to the seasonal build in the production bonus. Looking ahead to Q1, we anticipate our payout rate will decline to approximately 86.5% as the production bonus resets at the beginning of each year.

With respect to client cash revenue, it was $374 million, down $4 million from Q3, as average client cash balances declined slightly during the quarter. Client cash balances ended the quarter at $48 billion, up $1 billion sequentially, marking the first quarterly increase since the second quarter of 2022.

Within our ICA portfolio, the mix of fixed rate balances ended the quarter at roughly 60%, within our target range of 50% to 75%.

As a reminder, during Q4 there were roughly $2.5 billion of fixed rate contracts that matured. We placed $2 billion of these maturing balances into new, five-year contracts yielding approximately 415 basis points, which is roughly 85 basis points higher than their prior yield.

Looking more closely at our ICA yield, it was 317 basis points in Q4, down one basis point from Q3. As for Q1, based on where client cash balances and interest rates are today, as well as the yields on our new fixed rate contracts, we expect our ICA yield to increase by approximately 5 basis points.

As for Service and Fee revenue, it was $131 million in Q4, down $5 million from Q3. This decline was primarily driven by lower conference revenue, following our largest advisor conference of the year in Q3, as well as seasonally lower IRA fees. Looking ahead to Q1, we expect Service and Fee revenue to decrease by approximately $5 million sequentially on lower conference revenue.

Moving on to Q4 transaction revenue. It was $54 million, up $4 million sequentially due to increased trading volume. As we look ahead to Q1, based on what we have seen to date, we would expect transaction revenue to increase by a couple million sequentially.

Now let's turn to expenses, starting with Core G&A. It was $364 million in Q4, bringing our full year Core G&A to $1 billion $369 million. This was within our outlook range, and for the full year represents approximately 15% growth. As a reminder, this included an opportunistic 5% of incremental spend focused on accelerating our capabilities, as we took advantage of the favorable macro environment.

Now, as we look ahead to 2024, we plan to return to more normalized levels of spend, concentrating on investments that enable organic growth and drive operating leverage in our business. In addition, our ongoing investments to scale our business, are driving greater efficiencies. Pulling this together, we expect our 2024 core G&A growth rate to be roughly half the rate we saw in 2023. More specifically, we intend to grow 2024 Core G&A in a range of 6 and a quarter to 8 and three quarters percent.

As for Q1, we expect Core G&A to be in a range of $360 to $370 million.

Note that this Core G&A spend is prior to expenses associated with Prudential. As we move closer to onboarding them towards the end of this year, we'll provide an update on 2024 Core G&A. I would just emphasize that we expect only a small amount of spend in 2024, as the majority of these costs will be incurred in 2025.

Moving on to Q4 promotional expense. It was $138 million, down $2 million sequentially, as lower conference spend was partially offset by higher Prudential-related onboarding and integration costs.

Looking ahead to Q1, we expect promotional expense to be roughly flat, as we have one of our largest advisor conferences during the quarter, which will be offset by seasonal declines in marketing spend.

As for regulatory expense, it was $9 million in Q4. Looking forward, given the increased size and scale of our business, we would expect regulatory expense to be roughly $10 million per quarter.

Looking at share-based compensation expense, it was $16 million in Q4, flat compared to Q3. As we look ahead, we anticipate this expense will increase by approximately $6 million sequentially, as Q1 tends to be our highest quarter of the year, given the timing of our annual stock awards.

Regarding capital management, our balance sheet remained strong in Q4 with corporate cash at $184 million. I would note that during the quarter we completed our first investment grade debt offering, issuing $750 million of senior notes. With that, our leverage ratio increased to 1.6 times, and is within our target leverage range of 1.5 to 2.5x.

Turning to how we deploy that capital, our framework remains focused on allocating capital aligned with the returns we generate: investing in organic growth first and foremost, pursuing M&A where appropriate, and returning excess capital to shareholders.

In Q4, we deployed capital across our entire framework, as we continued to invest to drive and support organic growth, allocated capital to M&A within our Liquidity & Succession solution, and returned capital to our shareholders, repurchasing $225 million dollars of shares. As we look ahead to Q1, we plan to repurchase $200 million dollars of our shares, keeping us on track to execute on our $2 billion dollar authorization over two years.

Turning now to interest expense, it was $54 million in Q4, up $6 million sequentially. Looking ahead to Q1, given current debt balances and interest rates, we expect interest expense to increase by approximately $7 million from Q4.

In closing, we delivered another quarter of strong business and financial results. As we look forward, we remain excited about the opportunities we see to continue investing to serve our advisors, grow our business, and create long-term shareholder value.

With that, Operator, please open the call for questions.